

**REPORT OF THE AUDIT OF THE
LEE COUNTY
FISCAL COURT**

**For The Fiscal Year Ended
June 30, 2006**



**CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS
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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
Honorable Ernie Fletcher, Governor
John R. Farris, Secretary
Finance and Administration Cabinet
Honorable Steve Mays, Lee County Judge/Executive
Honorable L.C. Reese, Former Lee County Judge/Executive
Members of the Lee County Fiscal Court

The enclosed report prepared by Ross & Company, PLLC, Certified Public Accountants, presents the financial statements of the governmental activities and each major fund of Shelby County, Kentucky, as of and for the year ended June 30, 2006, which collectively comprise the County's basic financial statements.

We engaged Ross & Company, PLLC to perform the audit of these financial statements. We worked closely with the firm during our report review process; Ross & Company, PLLC evaluated the Shelby County's internal controls and compliance with applicable laws and regulations.

Respectfully submitted,

A handwritten signature in cursive script, reading "Crit Luallen".

Crit Luallen
Auditor of Public Accounts

Enclosure



EXECUTIVE SUMMARY

AUDIT EXAMINATION OF THE LEE COUNTY FISCAL COURT

June 30, 2006

Ross and Company, PLLC has completed the audit of the Lee County Fiscal Court for fiscal year ended June 30, 2006. We have issued unqualified opinions on the governmental activities and each major fund of Lee County, Kentucky.

Financial Condition:

The fiscal court had total net assets of \$3,710,967 as of June 30, 2006. The fiscal court had unrestricted net assets of \$391,373 in its governmental activities as of June 30, 2006, with total net assets of \$3,710,967. The fiscal court had total debt principal as of June 30, 2006, of \$671,514 with \$340,028 due within the next year.

Deposits:

The fiscal court's deposits were insured and collateralized by bank securities.

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To the People of Kentucky
Honorable Ernie Fletcher, Governor
John R. Farris, Secretary
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Members of the Lee County Fiscal Court

Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities and each major fund of Lee County, Kentucky, as of and for the year ended June 30, 2006, which collectively comprise the County's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Lee County Fiscal Court. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for Fiscal Court Audits issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in Note 1, Lee County, Kentucky, prepares its financial statements on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of Lee County, Kentucky, as of June 30, 2006, and the respective changes in financial position, where applicable, thereof for the year then ended in conformity with the basis of accounting described in Note 1.

To the People of Kentucky
Honorable Ernie Fletcher, Governor
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Finance and Administration Cabinet
Honorable Steve Mays, Lee County Judge/Executive
Honorable L.C. Reese, Former Lee County Judge/Executive
Members of the Lee County Fiscal Court

The management's discussion and analysis and budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Lee County, Kentucky's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments and Non-Profit Organizations, and is not a required part of the basic financial statements. The schedule of expenditures of federal awards has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued our report dated September 27, 2006 on our consideration of Lee County, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Ross & Company", written in dark ink.

Ross & Company, PLLC

Audit fieldwork completed -
September 27, 2006

LEE COUNTY OFFICIALS

For The Year Ended June 30, 2006

Fiscal Court Members:

L.C. Reese	County Judge/Executive
Ronnie Paul Begley	Magistrate
Lenard Carl Ross	Magistrate
Bennie Todd	Magistrate
Everett L. Marshall	Magistrate

Other Elected Officials:

Tom Jones	County Attorney
Arthur Noe	Jailer
Russell Stamper	County Clerk
Emma Adams	Circuit Court Clerk
James Harvey Pelfrey	Sheriff
Gary Lutes	Property Valuation Administrator
Clayton Spencer (7/05-12/05)	Coroner
Gene Tester (1/06-Present)	Coroner

Appointed Personnel:

Pearl Spencer	County Treasurer
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LEE COUNTY
OFFICE OF THE JUDGE EXECUTIVE
P O B O X G
BEATTYVILLE, KY 41311
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E M A I L : L E E C O @ M I K R O T E C . C O M

Management's Discussion and Analysis
June 30, 2006

The financial management of Lee County, Kentucky offers readers of Lee County's financial statements this narrative overview and analysis of the financial activities of Lee County for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with other information that we have furnished in our letter of transmission and the notes to the financial statements.

Financial Highlights

Lee County had net assets of \$3,710,967 as of June 30, 2006. Net assets included \$391,373 in unrestricted funds. Total debt principal as of June 30, 2006 was \$671,514 with \$340,028 due within one year.

The County's total net assets as of June 30, 2006 were \$3,710,967. Total net assets for 2005 were \$3,072,242 making an increase of \$638,725 from the prior year. This increase is due to the County buying three new dump trucks in the road department, a new ambulance, new fire truck, new rescue squad equipment, new air packs for Bear Track Fire Department, additional equipment for the remaining fire departments, and the continuing development of the Happy Top Park. We have built a new softball field, started construction on a baseball field, and almost completed a picnic shelter with restrooms at Happy Top.

At the close of the current fiscal year, Lee County had a fund balance of \$391,373. Of this amount, \$360,023 is available for spending at the fiscal court's discretion. (Cemetery Funds \$23,137, CDBG \$100, Sheriff's Equipment Grant \$113, And \$8,000 Litter Abatement Fund are the restricted funds.)

Lee County's total indebtedness as of June 30, 2006 was \$671,514 of which \$331,486 is long term (due after 1 year) and \$340,028 is short-term debt (to be paid within 1 year). Lee County added debt totaling \$288,800 for the purchase of three new dump trucks \$268,800 and \$20,000 to help with the renovation of the Regional Jail Library into cells to allow for additional housing. The County paid \$60,112 in principal on existing leases, making a net increase during the year of \$228,688.

During fiscal year 2005-2006 Lee County received and expended \$63,836 in a Community Corrections Treatment Grant in conjunction with Kentucky River Community Care for an in house drug treatment Program at the Regional Jail. Lee County received a State Grant in the amount of \$63,826 and upgraded all voting machines. Lee County in contract with the City of Beattyville received \$807,296 Community Development Block Grant funds for a Water Line and Storage Tank Project.

Overview of the Financial Statements

This management discussion and analysis is intended to serve as an introduction to Lee County's basic financial statements. Lee County's basic financial statements are comprised of three components: 1) government wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

GASB 34 requires management to include certain comparison schedules when they are available. These schedules include prior and current comparisons of general revenues by major source, and program expenses by function.

Lee County
Management Discussion and Analysis
June 30, 2006
(Continued)

Overview of the Financial Statements (Continued)

Government-wide Financial Statements. The *government-wide financial statements* are designed to provide readers with a broad overview of Lee County's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of Lee County's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator as to the improvement or deterioration of Lee County's financial position.

The *Statement of Activities* presents information showing how the government's net assets changed during the fiscal year. All changes in net assets are reported on a modified cash basis of accounting. Basis of accounting is reference to when financial events are recorded, such as the time for recognizing revenues, expenses, and related assets and liabilities.

Under Lee County's modified cash basis of accounting, revenues and expenses and related assets and liabilities are recorded when they result from a cash transaction. An exception occurs for the recording of depreciation expenses on capital assets in the government-wide financial statements for all activities and in the fund financial statements for the proprietary fund financial statements.

As a result of the use of this modified cash basis of accounting, certain assets and their related revenues (such as amounts billed for services provided, but not collected) and accounts payable (expenses for goods and services received but not paid) or compensated absences are not recorded.

Both of the government-wide financial statements distinguish functions of Lee County that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or significant portion of their costs through user fees and charges (*business-type activities*). Lee County's governmental activities include general government, protection to persons and property, general health and sanitation, social services, recreation and culture, roads, debt service, and capital projects. Lee County does not have any business activities.

The financial statements include not only Lee County itself (known as the primary government), but also legally separate entities, which have a significant operational or financial relationship with the County. Lee County has one such component unit, which is the Public Service Corporation and has been presented as a blended component unit.

Fund Financial Statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Lee County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of Lee County are *governmental funds*.

Governmental Funds. Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the government fund statement of revenues,

**Lee County
Management Discussion and Analysis
June 30, 2006
(Continued)**

Overview of the Financial Statements (Continued)

expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

Lee County maintains six individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the government fund statement of revenues, expenditures, and changes in fund balances for the General Fund, Road Fund, Jail Fund, LGEA, Ambulance Fund, and Solid Waste Fund.

Lee County adopts an annual appropriated budget for its major funds. A budgetary comparison statement has been provided for each of these funds to demonstrate compliance with their budgets.

Notes to the Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Government-wide Financial Analysis

Net Assets. As noted earlier, net assets may serve over time as a useful indicator of a government's financial position.

Lee County's net assets increased by \$638,725 in fiscal year ended June 30, 2006. Key elements of this increase are as follows:

1. Current assets and cash increased \$125.
2. Investment in capital assets, net of related debt increased \$620,780 due to purchasing 3 Mac Trucks and renovation of regional jail library into cells to allow additional housing along with buying a new ambulance, fire truck, rescue squad equipment, air packs for fire department.
3. Current and long-term liabilities increased by \$280,391.
4. Revenues were \$5,249,189 as reflected in the Statement of Activities.
5. Expenditures totaled \$4,628,285 as reflected in the Statement of Activities.

Lee County does not have any business-type activities.

Lee County
Management Discussion and Analysis
June 30, 2006
(Continued)

Table 1 presents a comparison of net assets as of June 30, 2005 and June 30, 2006.

Table 1
Net Assets Comparison-Governmental Activities

	2005	2006	Variance
Cash and Cash Equivalents	391,248	391,373	125
Other Current Assets		268,800	268,800
Capital Assets	<u>3,123,820</u>	<u>3,973,288</u>	<u>849,468</u>
Total Assets	<u>3,515,068</u>	<u>4,633,461</u>	<u>1,118,393</u>
Current Liabilities	59,637	340,028	280,391
Noncurrent Liabilities	<u>383,189</u>	<u>331,486</u>	<u>(51,703)</u>
Total Liabilities	<u>442,826</u>	<u>671,514</u>	<u>228,688</u>
Invested in Capital Assets net of related debt	2,680,994	3,319,594	638,600
Unrestricted Net Assets	<u>391,248</u>	<u>391,373</u>	<u>125</u>
Total Net Assets	<u><u>3,072,242</u></u>	<u><u>3,710,967</u></u>	<u><u>638,725</u></u>

Changes in net assets. The revenues and expenses information, as shown in Table 2, was derived from the Statement of Activities and reflects how Lee County's net assets changed during the fiscal year ended June 30, 2006.

Lee County
Management Discussion and Analysis
June 30, 2006
(Continued)

Table 2
Statement of Activities Comparison-Governmental Activities

Expenses:	2005	2006	Variance
General Government	594,970	611,871	16,901
Protection to Persons and Property	657,448	609,161	(48,287)
General Health and Sanitation	1,052,600	1,205,422	152,822
Social Services	51,396	51,924	528
Recreation and Culture	39,441	85,502	46,061
Roads	602,175	822,481	220,306
Interest on Long-Term Debt	27,871	29,141	1,270
Capital Projects	78,708	1,194,963	1,116,255
Total Expenses	<u>3,104,609</u>	<u>4,610,465</u>	<u>1,505,856</u>
Revenues:			
Charges for Services	1,195,331	1,157,804	(37,527)
Operating Grants and Contributions	1,013,526	1,817,023	803,497
Capital Grants and Contributions	1,080,395	807,295	(273,100)
General Revenues	<u>833,602</u>	<u>1,467,067</u>	<u>633,465</u>
Change in Net Assets	1,018,245	638,724	(379,521)
Beginning Net Assets	<u>2,053,997</u>	<u>3,072,243</u>	<u>1,018,246</u>
Ending Net Assets	<u>3,072,242</u>	<u>3,710,967</u>	<u>638,725</u>

Financial Analysis of the County's Funds.

As noted earlier, Lee County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds Overview. The focus of Lee County governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the County's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the June 30, 2006 fiscal year, the combined ending fund balance of Lee County funds was \$391,373. (\$360,023) of this consists of unreserved fund balance, which is available as working capital and for current spending in accordance with the purposes of the specific funds. The remainder of fund balance (\$31,350) is reserved to indicate that it is not available for new spending because it is committed.

The County has six major funds. These are 1) General Fund; 2) Road Fund; 3) Jail Fund; 4) Local Government Economic Assistance Fund; 5) Ambulance Fund; and 6) Solid Waste Fund.

**Lee County
Management Discussion and Analysis
June 30, 2006
(Continued)**

Financial Analysis of the County's Funds. (Continued)

Major Funds

1. The General Fund is the chief operating fund of Lee County. At the end of the June 30, 2006 fiscal year, unreserved fund balance of the General Fund was \$204,042 while total fund balance was \$227,392. The County received \$736,806 in taxes (\$697,463 in tax revenues plus \$39,343 in 911 fees). This accounts for approximately 30% of the general fund revenue. The General Fund supplemented the Ambulance Fund \$50,000. Total Expenditures for the General Fund for the fiscal year was \$2,580,941 compared to 1,415,338 in fiscal year 2005. Revenues for the fiscal year were \$2,432,657 while revenues for the previous fiscal year were \$1,422,558. The increase in revenues and expenditures for the fiscal year was due to County receiving a CDBG Grant for Transmission line and Water Storage Tank (\$807,296 funds received), Coal Severance Monies for Projects in the County (\$484,078 funds received), and a Grant for a Drug Treatment Program for the Regional Jail (\$63,826).
2. The Road Fund is the fund related to county road and bridge construction and maintenance. The Road Fund had \$63,123 in fund balance at June 30, 2006. The fund balance at the end of the previous year was \$96,379. The fiscal year expenditures for the road fund was 1,478,286 compared to \$1,220,412 in the previous fiscal year. The County spent \$421,609 for blacktop and enviropatch. The State Allotment toward the amount spent on blacktop was \$295,500. The County bought 3 new MAC dump trucks through a lease with KACo.
3. The Jail Fund had \$13,145 in cash as the end of fiscal year 2006. The total cash balance was unrestricted. During fiscal year 2006 total expenditures was \$234,553. Total expenditures for fiscal year 2005 was \$202,464. The increase in cost for fiscal year 2006 is due to the County paying lodging for each prisoner housed at regional jail. During fiscal year 2005 the county was only paying lodging for 15 prisoners per day. The County transferred \$190,000 into the Jail Fund from LGEA. The County only received \$47,940 in Revenues for the Jail during fiscal year 2006. Total funds transferred accounted for 77% for the Jail Fund.
4. The LGEA is a fund made up of receipts derived from coal severance and mineral receipts. Lee County fluctuates from being a coal-producing county to a coal impact county. In fiscal year 2006, Lee County received two quarters of Coal impact monies (\$29,958) and two quarters of coal producing monies (\$65,859) and mineral tax totaling \$240,840. The major function of Lee County's LGEA fund is to supplement the Jail Fund. In fiscal year 2006, \$190,000 was transferred to the jail. A total of \$50,000 LGEA funds were transferred to Lee County Ambulance Fund. The remaining expenditures were spent for road maintenance (\$83,502) on coal haul roads, Pride Cleanup and Other Solid Waste Activities (\$36,905).
5. The Ambulance Fund is the fund related to billing and collection of ambulance transports. At the end of June 30, 2006 total cash balance was \$14,835 compared to \$9,885 at the end of June 30, 2005. During the fiscal year the total expenditures reflected personnel and operating cost of \$916,583. During fiscal year 2004-05 the total expenditures for the ambulance service was \$920,384, which included the purchase of an ambulance. The cost of operating the ambulance service increased due to rise in personnel cost, insurance, and gasoline. The ambulance fund was supplemented \$100,000 from General Fund and LGEA Fund during the fiscal year. During the current fiscal year fees collected was \$791,856 compared to \$773,932 in fiscal year 2004-05.
6. The Solid Waste Fund is the fund related to billing and collection of the Solid Waste Department. Total fund balance at the end of June 30, 2006 was \$34,895 of which \$8,000 was reserved for Litter Abatement Activities. The remaining balance of \$26,895 is unreserved. Total Garbage Collection fees for the fiscal year were \$360,399 (averaging \$30,033 per month) while total expenditures were \$401,588 (averaging \$33,466 a month). Although expenditures were in excess

**Lee County
Management Discussion and Analysis
June 30, 2006
(Continued)**

Financial Analysis of the County's Funds. (Continued)

Major Funds (Continued)

of fees collected, the Solid Waste Fund had prior year surplus to make up the difference. Some landfill fees were paid through the LGEA fund. A total of \$24,748 was expended for Litter Abatement Activities during the fiscal year. The ending balance at June 30, 2005 of \$51,816 reflected \$13,471 of litter abatement funds reserved for spending in the current fiscal year. Total principal and interest paid for fiscal year 2005-06 was \$29,869.

General Fund Budgetary Highlights.

The General Fund original budget was amended during the fiscal year increasing the budget by \$157,166. Total budget for fiscal year 2006 was \$2,392,668 compared to fiscal year 2005 budget of \$1,405,095.

Capital Assets and Debt Administration.

Capital Assets. Lee County's investment in capital assets for its government type activities as of June 30, 2006 amounts to \$3,722,308 (net of accumulated depreciation). This investment in capital assets includes land, buildings, improvements to land other than buildings, machinery and equipment, and vehicles and infrastructure.

Major capital asset events during the 2006 fiscal year included the County adding blacktop roads, development of Happy Top Park, adding new equipment purchased through Coal Severance Monies. Total Capital assets increased \$849,468 from last fiscal year.

Long-Term Debt. At the end of the 2006 fiscal year, Lee County had total long-term debt outstanding of \$671,514. The amount of debt due within the next year is \$340,028 and \$331,486 is due in subsequent years. This debt is for a truck, backhoe, 3 MAC trucks, and solid waste equipment and for paving. The debt for the truck and backhoe will be retired in FY 07.

Other Matters. The following factors are expected to have a significant effect on the County's financial position or results of operations and were taken into account in developing the 2006 fiscal year budget:

The 2006 fiscal year adopted budget continues most services at current levels with the exception for which federal or state funding is decreasing or for projects that have been completed or nearing completion.

The Fiscal Court will have to continue to supplement the Ambulance Fund and Solid Waste Fund. The Fiscal Court will have to be conservative with LGEA projections due to the fluctuating of Coal Impact and Coal Producing receipts. The Court will have the addition of the Happy Top Park to maintain.

Requests For Information

This financial report is designed to provide a general overview of Lee County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this or requests for additional financial information should be addressed to the Lee County Treasurer, PO Box G, Beattyville, KY 41311.

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LEE COUNTY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS

June 30, 2006

LEE COUNTY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS

June 30, 2006

	Primary Government Governmental Activities
ASSETS	
Current Assets:	
Cash and Cash Equivalents	\$ 391,373
Capital Assets Held for Resale	268,800
Total Current Assets	<u>660,173</u>
Noncurrent Assets:	
Capital Assets - Net of Accumulated Depreciation	
Land	240,094
Construction In Progress	58,200
Buildings	1,501,845
Other Equipment	179,397
Vehicles	547,734
Equipment	239,818
Infrastructure	955,220
Total Noncurrent Assets	<u>3,722,308</u>
Total Assets	<u>4,382,481</u>
LIABILITIES	
Current Liabilities:	
Financing Obligations Payable	340,028
Total Current Liabilities	<u>340,028</u>
Noncurrent Liabilities:	
Financing Obligations Payable	331,486
Total Noncurrent Liabilities	<u>331,486</u>
Total Liabilities	<u>671,514</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	3,319,594
Unrestricted	391,373
Total Net Assets	<u><u>\$ 3,710,967</u></u>

The accompanying notes are an integral part of the financial statements

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LEE COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For The Year Ended June 30, 2006

LEE COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

Functions/Programs Reporting Entity	Expenses	Program Revenues Received		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government:				
Governmental Activities:				
General Government	\$ 611,871	\$ 5,229	\$ 234,379	\$
Protection to Persons and Property	1,335,916	791,856	66,098	
General Health and Sanitation	478,667	360,399	39,787	807,295
Social Services	51,924			
Recreation and Culture	85,502	320		
Roads	822,481		1,476,759	
Debt Service (Interest)	29,141			
Capital Projects	1,194,963			
Total Governmental Activities	4,610,465	1,157,804	1,817,023	807,295
Totals	\$ 4,610,465	\$ 1,157,804	\$ 1,817,023	\$ 807,295

General Revenues:

Taxes:

 Real Property Taxes

 Personal Property Taxes

 Motor Vehicle Taxes

 Other Taxes

 In Lieu Tax Payments

 Excess Fees

 Licenses and Permits

 Miscellaneous Revenues

 Accrued Interest Received

 Total General Revenues

 Change in Net Assets

Net Assets - Beginning

Net Assets - Ending

The accompanying notes are an integral part of the financial statements.

LEE COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For The Year Ended June 30, 2006
(Continued)

<u>Net (Expenses) Revenues</u> <u>and Changes in Net Assets</u>	
<u>Primary Government</u>	
<u>Governmental</u> <u>Activities</u>	
\$	(372,263)
	(477,962)
	728,814
	(51,924)
	(85,182)
	654,278
	(29,141)
	<u>(1,194,963)</u>
	<u>(828,343)</u>
	<u>(828,343)</u>
	475,926
	101,949
	64,928
	578,081
	17,898
	4,034
	17,408
	202,410
	<u>4,433</u>
	<u>1,467,067</u>
	638,724
	<u>3,072,243</u>
\$	<u><u>3,710,967</u></u>

The accompanying notes are an integral part of the financial statements.

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LEE COUNTY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

June 30, 2006

LEE COUNTY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

June 30, 2006

	General Fund	Road Fund	Jail Fund	Local Government Economic Assistance Fund	Ambulance Fund
ASSETS					
Cash and Cash Equivalents	\$ 227,392	\$ 63,123	\$ 13,145	\$ 37,983	\$ 14,835
Total Assets	<u>\$ 227,392</u>	<u>\$ 63,123</u>	<u>\$ 13,145</u>	<u>\$ 37,983</u>	<u>\$ 14,835</u>
FUND BALANCES					
Reserved for:					
Encumbrances	\$ 41,667	\$ 32,089	\$	\$	\$ 5,407
Unreserved:					
General Fund	185,725				
Special Revenue Funds		31,034	13,145	37,983	9,428
Total Fund Balances	<u>\$ 227,392</u>	<u>\$ 63,123</u>	<u>\$ 13,145</u>	<u>\$ 37,983</u>	<u>\$ 14,835</u>

The accompanying notes are an integral part of the financial statements.

LEE COUNTY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
June 30, 2006
(Continued)

Solid Waste Fund	Total Governmental Funds
\$ 34,895	\$ 391,373
<u>\$ 34,895</u>	<u>\$ 391,373</u>
\$ 4,461	\$ 83,624
	185,725
<u>30,434</u>	<u>122,024</u>
<u>\$ 34,895</u>	<u>\$ 391,373</u>

**Reconciliation of Balance Sheet - Governmental Funds
to Statement of Changes In Net Assets:**

Total Fund Balances	\$ 391,373
Amounts Reported for Governmental Activities in the Statement of Net Assets Are Different Because:	
Capital Assets Used in Governmental Activities Are Not Financial Resources and Therefore Are Not Reported in the Funds.	4,999,636
Accumulated Depreciation	(1,277,328)
Capital Assets Held For Resale	268,800
Long-term and Short-term Debt Is Not Due and Payable in the Current Period and, Therefore, Is Not Reported in the Funds.	
Financing Obligations	<u>(671,514)</u>
Net Assets of Governmental Activities	<u>\$ 3,710,967</u>

The accompanying notes are an integral part of the financial statements.

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LEE COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

LEE COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

	General Fund	Road Fund	Jail Fund	Local Government Economic Assistance Fund
REVENUES				
Taxes	\$ 736,806	\$	\$	\$
In Lieu Tax Payments	9,663	8,235		
Excess Fees	4,034			
Licenses and Permits	17,408			
Intergovernmental	1,554,586	1,113,816	47,758	362,942
Charges for Services	5,549			
Miscellaneous	102,235	75,923	40	
Interest	2,376	1,156	142	320
Total Revenues	<u>2,432,657</u>	<u>1,199,130</u>	<u>47,940</u>	<u>363,262</u>
EXPENDITURES				
General Government	560,018			
Protection to Persons and Property	273,883		228,988	
General Health and Sanitation	23,787			83,502
Social Services	48,852			
Recreation and Culture	90,633			
Roads		1,289,497		41,012
Debt Service-Principal	2,392	36,889		
Debt Service-Interest	3,351	16,752		
Capital Projects	1,194,963			
Administration	<u>211,562</u>	<u>108,048</u>	<u>5,565</u>	
Total Expenditures	<u>2,409,441</u>	<u>1,451,186</u>	<u>234,553</u>	<u>124,514</u>
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	<u>23,216</u>	<u>(252,056)</u>	<u>(186,613)</u>	<u>238,748</u>
Other Financing Sources (Uses)				
Lease Proceeds	20,000			
KACO Lease-Mac Trucks		268,800		
Transfers From Other Funds	50,000		190,000	
Transfers To Other Funds	<u>(50,000)</u>	<u>(50,000)</u>	<u></u>	<u>(240,000)</u>
Total Other Financing Sources (Uses)	<u>20,000</u>	<u>218,800</u>	<u>190,000</u>	<u>(240,000)</u>
Net Change in Fund Balances	43,216	(33,256)	3,387	(1,252)
Fund Balances - Beginning	184,176	96,379	9,758	39,235
Fund Balances - Ending	<u>\$ 227,392</u>	<u>\$ 63,123</u>	<u>\$ 13,145</u>	<u>\$ 37,983</u>

The accompanying notes are an integral part of the financial statements.

LEE COUNTY
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
For The Year Ended June 30, 2006
(Continued)

Ambulance Fund	Solid Waste Fund	Total Governmental Funds
\$	\$	\$ 736,806
		17,898
		4,034
		17,408
10,017	19,277	3,108,396
791,856	360,399	1,157,804
19,415	4,797	202,410
245	194	4,433
<u>821,533</u>	<u>384,667</u>	<u>5,249,189</u>
		560,018
726,755		1,229,626
	300,927	408,216
		48,852
		90,633
		1,330,509
	20,831	60,112
	9,038	29,141
		1,194,963
<u>189,828</u>	<u>70,792</u>	<u>585,795</u>
<u>916,583</u>	<u>401,588</u>	<u>5,537,865</u>
<u>(95,050)</u>	<u>(16,921)</u>	<u>(288,676)</u>
		20,000
		268,800
100,000		340,000
		(340,000)
<u>100,000</u>		<u>288,800</u>
4,950	(16,921)	124
9,885	51,816	391,249
<u>\$ 14,835</u>	<u>\$ 34,895</u>	<u>\$ 391,373</u>

The accompanying notes are an integral part of the financial statements.

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**LEE COUNTY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS**

For The Year Ended June 30, 2006

LEE COUNTY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

Net Change in Fund Balances - Total Governmental Funds	\$	124
--	----	-----

Amounts Reported for Governmental Activities in the
Statement of Activities Are Different Because:

Governmental Funds Report Financing Obligations as Other Financing Sources. However, in the Statement of Activities These Are Not Shown As A Revenue		(288,800)
---	--	-----------

Governmental Funds Report Capital Outlays as Expenditures. However, in the
Statement of Activities the Cost of those Assets Are Allocated over their
Estimated Useful Lives and Reported as Depreciation Expense.

Capital Outlay		867,404
Assets Held For Resale		268,800
Depreciation Expense		(243,620)
Asset Disposal, Net Value		(25,296)

The Issuance of Long-term Debt Provides Current Financial Resources
to Governmental Funds While the Repayment of Principal on
Long-term Debt Consumes the Current Financial Resources of
Governmental Funds.

Financing Obligations Principal Payments		60,112
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Change in Net Assets of Governmental Activities	\$	638,724
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The accompanying notes are an integral part of the financial statements

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To The Financial Statements**

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**LEE COUNTY
NOTES TO FINANCIAL STATEMENTS**

June 30, 2006

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

The county presents its government wide and fund financial statements in accordance with a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this basis of accounting, assets, liabilities, and related revenues and expenditures are recorded when they result from cash transactions, with a few exceptions. This modified cash basis recognizes revenues when received and expenditures when paid. Notes receivable are recognized on the Statement of Net Assets, but notes receivables are not included and recognized on the Balance Sheet – Governmental Funds. Property tax receivables, accounts payable, compensated absences, and donated assets, among other items, are not reflected in the financial statements.

Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however encumbrances are reflected on the Balance Sheet - Governmental Funds as part of the fund balance (Reserved for Encumbrances).

The State Local Finance Officer does not require the county to report capital assets and infrastructure; however the value of these assets are included in the Statement of Net Assets and their corresponding depreciation expenses is included on the Statement of Activities.

B. Reporting Entity

The financial statements of Lee County include the funds, agencies, boards, and entities for which the fiscal court is financially accountable. Financial accountability, as defined by Section 2100 of the Governmental Accounting Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards, as amended by GASB 14 and GASB 39, was determined on the basis of the government's ability to significantly influence operations, select the governing authority, participate in fiscal management and the scope of public service. Consequently, the reporting entity includes organizations that are legally separate from the primary government. Legally separate organizations are reported as component units if either the county is financially accountable or whose exclusion would cause the county's financial statements to be misleading or incomplete. Component units may be blended or discretely presented. Blended component units either provide their services exclusively or almost entirely to the primary government, or their governing bodies are substantively the same as the primary government. All other component units are discretely presented. The County has no discretely presented component units.

Blended Component Unit

The following legally separate organization provides its services exclusively to the primary government, and the fiscal court is able to impose its will on this organization. This organization's balances and transactions are reported as though they are part of the county's primary government using the blending method.

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

B. Reporting Entity (Continued)

Public Service Corporation

The Public Service Corporation is a legally separate entity established to provide debt service for the purchase of real estate property from the Kentucky Mountains Farm Cooperative. The Public Service Corporation's governing body consists entirely of Fiscal Court members. Therefore, management should include the Public Service Corporation as a component unit, and its financial activity should be blended with the Fiscal Court. However, the Public Service Corporation had no financial activity during the year and had no financial information to blend with that of the fiscal court.

C. Lee County Elected Officials

Kentucky law provides for election of the officials below from the geographic area constituting Lee County. Pursuant to state statute, these officials perform various services for the Commonwealth of Kentucky, its judicial courts, the fiscal court, various cities and special districts within the county, and the board of education. In exercising these responsibilities, however, they are required to comply with state laws. Audits of their financial statements are issued separately and individually and can be obtained from their respective administrative offices. These financial statements are not required to be included in the financial statements of Lee County, Kentucky.

- Circuit Court Clerk
- County Attorney
- Property Valuation Administrator
- County Clerk
- County Sheriff

D. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government. For the most part, the effect of interfund activities has been removed from these statements. Governmental activities are normally supported by taxes and intergovernmental revenues.

The statement of net assets presents the reporting entity's non-fiduciary assets and liabilities, the difference between the two being reported as net assets. Net assets are reported in three categories: 1) invested in capital assets, net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets; 2) restricted net assets - resulting from constraints placed on net assets by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; and 3) unrestricted net assets - those assets that do not meet the definition of restricted net assets or invested in capital assets.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include: 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function; 2) operating grants and contributions; and 3) capital grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Internally dedicated resources such as taxes and unrestricted state funds are reported as general revenues.

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

D. Government-wide and Fund Financial Statements (Continued)

Funds are characterized as either major or non-major. Since there is only one type (governmental) presented for Lee County, major funds are those whose assets, liabilities, revenues, or expenditures/expenses are at least ten percent of the corresponding total for all governmental funds combined. The fiscal court may also designate any fund as major. Major individual governmental funds are reported as separate columns in the financial statements.

Governmental Funds

The government reports the following major governmental funds:

General Fund - This is the primary operating fund of the fiscal court. It accounts for all financial resources of the general government, except where the Governor's Office for Local Development requires a separate fund or where management requires that a separate fund be used for some function.

Road Fund - This fund is for road and bridge construction and repair. The primary source of revenue for this fund is state payments for truck license distribution, municipal road aid, and transportation grants. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the General Fund.

Jail Fund - The primary purpose of this fund is to account for the jail expenses of the county. The primary sources of revenue for this fund are reimbursements from the state and federal government, payments from other counties for housing prisoners, and transfers from the General Fund. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the General Fund.

Local Government Economic Assistance Fund - The purpose of this fund is to account for local government development funds received from the state government. The funds may be used for road, protection of persons and property, social services and general health and sanitation expenditures.

Ambulance Fund - This fund accounts for all revenues from uses of the Ambulance Service along with some state contributions.

Solid Waste Fund - The primary purpose of this fund is to account for the solid waste expenses of the county. The primary sources of revenue for this fund are monthly collection fees and from the state and federal government. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the general fund.

Special Revenue Funds:

The Road Fund, Jail Fund, Local Government Economic Assistance Fund, Ambulance Fund, and the Solid Waste Fund are special revenue funds. These funds are used to account for the proceeds of specific revenue sources and expenditures that are legally restricted for specific purposes.

Generally and except as otherwise provided by law, property taxes are assessed as of January 1, levied (mailed) November 1, due at discount November 30, due at face value December 31, delinquent January 1 following assessment, and subject to lien and sale the 3rd Saturday in April following the delinquency date.

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

E. Deposits and Investments

The government's cash and cash equivalents are considered to be cash on hand, demand deposits, certificates of deposit, and short-term investments with original maturities of three months or less from the date of acquisition.

KRS 66.480 authorizes the county to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

F. Capital Assets

Capital assets, which include land, land improvements, buildings, furniture and office equipment, building improvements, machinery, equipment, and infrastructure assets (roads and bridges) that have a useful life of more than one reporting period based on the government's capitalization policy, are reported in the applicable governmental or business-type activities of the government-wide financial statements. Such assets are recorded at historical cost or estimated historical cost when purchased or constructed

Cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Land and Construction In Progress are not depreciated. Interest incurred during construction is not capitalized. Capital assets and infrastructure are depreciated using the straight-line method of depreciation over the estimated useful life of the asset.

	Capitalization Threshold	Useful Life (Years)
Land Improvements	\$ 12,500	10-60
Buildings and Building Improvements	\$ 25,000	10-75
Machinery and Equipment	\$ 2,500	3-25
Vehicles	\$ 2,500	3-25
Infrastructure	\$ 20,000	10-50

G. Long-term Obligations

In the government-wide financial statements, long term debt and other long-term obligations are reported as liabilities in the applicable financial statements. The principal amount of bonds, notes and KACO Leasing Trust financing obligations are reported.

In the fund financial statements, governmental fund types recognize bond interest, as well as bond issuance costs when received or when paid, during the current period. The principal amount of the debt and interest are reported as expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures. Debt proceeds are reported as other financing sources.

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

H. Fund Equity

In the fund financial statements, the difference between the assets and liabilities of governmental funds is reported as fund balance. Fund balance is divided into reserved and unreserved components, with unreserved considered available for new spending. Unreserved fund balances may be divided into designated and undesignated portions. Designations represent fiscal court's intended use of the resources and should reflect actual plans approved by the fiscal court.

Governmental funds report reservations of fund balance for amounts that are legally restricted by outside parties for use for a specific purpose and encumbrances. "Reserved for Encumbrances" are purchase orders that will be fulfilled in a subsequent fiscal period. Although the purchase order or contract creates a legal commitment, the fiscal court incurs no liability until performance has occurred on the part of the party with whom the fiscal court has entered into the arrangement. When a government intends to honor outstanding commitments in subsequent periods, such amounts are encumbered. Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however, encumbrances are reflected on the Balance Sheet - Governmental Funds as part of the fund balance.

I. Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

J. Joint Venture

A legal entity or other organization that results from a contractual agreement and that is owned, operated, or governed by two or more participants as a separate activity subject to joint control, in which the participants retain (a) an ongoing financial interest or (b) an ongoing financial responsibility is a joint venture. Based upon these criteria, the following is considered a joint venture of the Lee County Fiscal Court:

Three Forks Regional Jail

On October 6, 2000, the Counties of Lee, Owsley, and Wolfe (the participating counties) entered into an Interlocal Cooperation Agreement in order to provide for joint and cooperative action in the acquisition, construction, installation, maintenance and financing of the Three Forks Regional Jail. Pursuant to this interlocal agreement, Lee County (the lead county) established the Three Forks Public Properties Corporation, a legally separate organization, to act as an agency and instrumentality of the participating counties in financing the acquisition and construction of the Three Forks Regional Jail. On December 1, 2000, the corporation issued \$6,295,000 of first mortgage revenue bonds.

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

J. Joint Venture (Continued)

Three Forks Region Jail (Continued)

The only source of funds expected by the Three Forks Public Properties Corporation to meet the debt service requirements on the bonds are the rental payments from the participating counties, as stipulated in the lease and sublease agreements dated October 1, 2000. Pursuant to the lease and sublease, each participating county covenants to meet its proportionate share of the debt service requirements on the bonds as follows (the "proportionate share" or "use allowance"): 40% for Lee County, 22% for Owsley County and 38% for Wolfe County.

On December 1, 2000, the three participating counties established the Three Forks Regional Jail Authority pursuant to the provisions of KRS 441.800 and KRS 441.810 to act as the constituted authority of the participating counties in the acquisition, construction, equipping and operation of the Three Forks Regional Jail.

The Three Forks Regional Jail Authority and the Three Fork's Public Properties Corporation are comprised of an eight (8) member board of directors. Lee County appoints three of the eight members. Wolfe and Owsley counties appoint two members each. In addition, the Lee county jailer is a required member of the board.

A copy of the Three Forks Regional Jail Authority's audit report may be obtained by writing the Three Forks Regional Jail, 2475 Center Street, Beattyville, Kentucky 41311.

Note 2. Deposits

The primary government and component units maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) in accordance with KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the county and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the government's deposits may not be returned to it. Lee County Fiscal Court does not have a deposit policy for custodial credit risk, but rather follows the requirements of KRS 41.240(4). As of June 30, 2006, all deposits were covered by FDIC insurance or a properly executed collateral security agreement.

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 3. Capital Assets

Capital Asset activity for the year ended June 30, 2006 was as follows:

	Reporting Entity			
	Beginning Balance	Increases	Decreases	Ending Balance
<u>Governmental Activities:</u>				
Capital Assets Not Being Depreciated:				
Land and Land Improvements	\$ 174,244	\$ 65,850	\$	\$ 240,094
Construction In Progress		58,200		58,200
Total Capital Assets Not Being Depreciated	174,244	124,050		298,294
Capital Assets, Being Depreciated:				
Buildings	2,005,607	22,368		2,027,975
Other Equipment	179,521	108,086		287,607
Vehicles	827,816	163,683	(97,935)	893,564
Equipment	472,562	28,940	(59,000)	442,502
Infrastructure	629,417	420,277		1,049,694
Total Capital Assets Being Depreciated	4,114,923	743,354	(156,935)	4,701,342
Less Accumulated Depreciation For:				
Buildings	(497,820)	(28,310)		(526,130)
Other Equipment	(71,505)	(36,705)		(108,210)
Vehicles	(351,222)	(81,833)	87,225	(345,830)
Equipment	(214,915)	(32,183)	44,414	(202,684)
Infrastructure	(29,885)	(64,589)		(94,474)
Total Accumulated Depreciation	(1,165,347)	(243,620)	131,639	(1,277,328)
Total Capital Assets, Being Depreciated, Net	2,949,576	499,734	(25,296)	3,424,014
Governmental Activities Capital Assets, Net	<u>\$ 3,123,820</u>	<u>\$ 623,784</u>	<u>\$ (25,296)</u>	<u>\$ 3,722,308</u>
<u>Governmental Activities:</u>				
General Government			\$ 29,341	
Protection to Persons and Property			83,500	
General Health and Sanitation			27,242	
Social Services			3,072	
Recreation and Culture			9,577	
Roads			90,888	
Total Depreciation Expense - Governmental Activities			\$ 243,620	

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 4. Short-Term Debt

A. Kentucky Advance Revenue Program

In July 2005, Lee County participated in the Kentucky Association of Counties Kentucky Advance Revenue Program by issuing a note in the amount of \$198,600, with principal being due in January 2006.

B. Mac Truck

In January 2006, the county entered into a lease agreement for \$268,800 with Kentucky Association of Counties Leasing Trust Program for the purchase of three Mac trucks. Terms of the agreement stipulate a one-year repayment schedule, with variable monthly interest payments and a fixed yearly principal payment. The principal of \$268,800 and final payment is due on February 20, 2007. The county purchased the trucks to use for one year; then the trucks will be sold at auction. Lease payments for the remaining year are:

<u>Fiscal Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 268,800	\$ 8,331
Totals	<u>\$ 268,800</u>	<u>\$ 8,331</u>

C. Changes in Short-Term Liabilities

Short-term liability activity for the year ended June 30, 2006, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
<u>Governmental Activities:</u>				
Kentucky Advance Revenue Program	\$ 0	\$ 198,600	\$ 198,600	\$ 0
Financing Obligations		<u>268,800</u>		<u>268,800</u>
Governmental Activities Short-Term Liabilities	<u>\$ 0</u>	<u>\$ 467,400</u>	<u>\$ 198,600</u>	<u>\$ 268,800</u>

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 5. Long-Term Debt

A. Truck/Backhoe

In July 1997, the county entered into a financing obligation agreement for \$71,000 with Kentucky Association of Counties Leasing Trust Program for a truck and a backhoe. Terms of the agreement stipulate a ten-year repayment schedule, with variable monthly interest payments and variable annual principal payments. The principal amount is due on January 20 of each year to end on January 20, 2007. As of June 30, 2006, the principal balance was \$6,000. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Principal	Interest
2007	6,000	197
Totals	<u>\$ 6,000</u>	<u>\$ 197</u>

B. Brush Cutter

In July 2000, the county entered into a financing obligation agreement for \$48,510 with Kentucky Association of Counties Leasing Trust Program for a brush cutter. Terms of the agreement stipulate a five-year repayment schedule with variable monthly interest payments and variable monthly principal payments. The final payment was made in 2006, and as of June 30, 2006 the principal balance was \$0.

C. Road Paving

In May 2002, the county entered into a financing obligation agreement for \$300,000 with Kentucky Association of Counties Leasing Trust Program for road paving. Terms of the agreement stipulate a ten-year repayment schedule, with variable monthly interest payments and variable annual principal payments. The principal amount is due on January 20 of each year to end on January 20, 2012. As of June 30, 2006, the principal balance was \$195,000. Obligations for the remaining years are:

Fiscal Year Ended June 30	Principal	Interest
2007	30,000	8,890
2008	30,000	7,429
2009	30,000	5,968
2010	35,000	4,405
2011-2012	<u>70,000</u>	<u>3,695</u>
Totals	<u>\$ 195,000</u>	<u>\$ 30,387</u>

D. Solid Waste Equipment

In July 2003, the county entered into a financing obligation agreement for \$325,000 with Kentucky Association of Counties for a multi-purpose agreement for the purchase of solid waste equipment. However the county only used \$250,241 of the proceeds. During December 2003, the County Judge/Executive requested that the balance of the agreement be applied towards the principal thereby reducing monthly payments. Terms of the agreement stipulate a ten-year repayment schedule, with variable monthly interest payments and variable monthly principal payments to end on June 30, 2013. As of June 30, 2006, the principal balance was \$184,106. Payments for the remaining years are:

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 5. Long-term Debt (Continued)

D. Solid Waste Equipment (Continued)

Fiscal Year Ended June 30	Principal	Interest
2007	25,356	6,666
2008	24,151	5,278
2009	24,885	4,417
2010	25,642	3,532
2011	26,421	2,619
2012-2013	57,651	2,411
Totals	<u>\$ 184,106</u>	<u>\$ 24,923</u>

E. Jail Library Renovation

In February 2006, the county entered into a financing obligation agreement for \$20,000 with Kentucky Association of Counties Leasing Trust Program for funds to perform a renovation of the jail library. Terms of the agreement stipulate a two-year repayment schedule, with variable monthly interest payments and variable monthly principal payments. The principal amount is due on 20th day of each month to end on March 20, 2008. As of June 30, 2006, the principal balance was \$17,608. Lease payments for the remaining years are:

Fiscal Year Ended June 30	Principal	Interest
2007	\$ 9,872	\$ 645
2008	7,736	246
Totals	<u>\$ 17,608</u>	<u>\$ 891</u>

F. Changes In Long-term Liabilities

Long-term liability activity for the year ended June 30, 2006, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Primary Government:					
<u>Governmental Activities:</u>					
Financing Obligations	<u>\$ 442,826</u>	<u>\$ 20,000</u>	<u>\$ 60,112</u>	<u>\$ 402,714</u>	<u>\$ 71,228</u>
Governmental Activities					
Long-term Liabilities	<u>\$ 442,826</u>	<u>\$ 20,000</u>	<u>\$ 60,112</u>	<u>\$ 402,714</u>	<u>\$ 71,228</u>

LEE COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 6. Employee Retirement System

The Fiscal Court has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost sharing, multiple-employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability, and death benefits to plan members. Benefit contributions and provisions are established by statute. Nonhazardous covered employees are required to contribute 5 percent of their salary to the plan. The county's contribution rate for nonhazardous employees was 10.98 percent.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, Kentucky 40601-6124, or by telephone at (502) 564-4646

Note 7. Interest On Long-term Debt and Financing Obligations

Debt Service on the Statement of Activities includes \$29,141 in interest on financing obligations.

Note 8. Insurance

For the fiscal year ended June 30, 2006, Lee County was a member of the Kentucky Association of Counties' All Lines Fund (KALF). KALF is a self-insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public officials' errors and omissions, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses.

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LEE COUNTY
BUDGETARY COMPARISON SCHEDULES - MAJOR FUNDS
REQUIRED SUPPLEMENTARY INFORMATION

For The Year Ended June 30, 2006

LEE COUNTY
BUDGETARY COMPARISON SCHEDULES - MAJOR FUNDS
Required Supplementary Information - Modified Cash Basis

For The Year Ended June 30, 2006

	GENERAL FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Taxes	\$ 602,600	\$ 626,356	\$ 736,806	\$ 110,450
In Lieu Tax Payments	8,000	8,000	9,663	1,663
Excess Fees	1,225	1,225	4,034	2,809
Licenses and Permits	13,085	13,085	17,408	4,323
Intergovernmental Revenue	1,518,711	1,652,121	1,554,586	(97,535)
Charges for Services	8,375	8,375	5,549	(2,826)
Miscellaneous	83,406	83,406	102,235	18,829
Interest	100	100	2,376	2,276
Total Revenues	<u>2,235,502</u>	<u>2,392,668</u>	<u>2,432,657</u>	<u>39,989</u>
EXPENDITURES				
General Government	526,260	526,260	560,018	(33,758)
Protection to Persons and Property	198,067	261,893	273,883	(11,990)
General Health and Sanitation	15,536	15,536	23,787	(8,251)
Social Services	45,782	45,782	48,852	(3,070)
Recreation and Culture	56,900	56,900	90,633	(33,733)
Debt Service Principal	171,000	171,000	173,892	(2,892)
Debt Service Interest	2,777	2,777	3,351	(574)
Capital Projects	1,258,500	1,328,084	1,194,963	133,121
Administration	163,852	229,852	211,562	18,290
Total Expenditures	<u>2,438,674</u>	<u>2,638,084</u>	<u>2,580,941</u>	<u>57,143</u>
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	<u>(203,172)</u>	<u>(245,416)</u>	<u>(148,284)</u>	<u>97,132</u>
OTHER FINANCING SOURCES (USES)				
Kentucky Advance Revenue Program Proceeds	171,000	171,000	171,500	(500)
Lease Proceeds		20,000	20,000	
Transfers From Other Funds	67,756	67,756	50,000	(17,756)
Transfers To Other Funds	(205,284)	(197,040)	(50,000)	147,040
Total Other Financing Sources (Uses)	<u>33,472</u>	<u>61,716</u>	<u>191,500</u>	<u>128,784</u>
Net Changes in Fund Balance	(169,700)	(183,700)	43,216	226,916
Fund Balance - Beginning	<u>170,000</u>	<u>184,000</u>	<u>184,176</u>	<u>176</u>
Fund Balance - Ending	<u>\$ 300</u>	<u>\$ 300</u>	<u>\$ 227,392</u>	<u>\$ 227,092</u>

LEE COUNTY
BUDGETARY COMPARISON SCHEDULES - MAJOR FUNDS
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2006
(Continued)

	ROAD FUND			
	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts, (Budgetary Basis)	Final Budget Positive (Negative)
REVENUES				
In Lieu Tax Payments	\$ 8,294	\$ 8,294	\$ 8,235	\$ (59)
Intergovernmental Revenue	756,356	1,105,856	1,113,816	7,960
Miscellaneous	600	64,600	75,923	11,323
Interest	543	543	1,156	613
Total Revenues	765,793	1,179,293	1,199,130	19,837
EXPENDITURES				
Protection to Persons and Property				
Roads	531,991	1,216,535	1,289,497	(72,962)
Debt Service-Principal	68,313	68,313	63,989	4,324
Debt Service-Interest	16,156	16,156	16,752	(596)
Administration	178,677	214,189	108,048	106,141
Total Expenditures	795,137	1,515,193	1,478,286	36,907
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	(29,344)	(335,900)	(279,156)	56,744
OTHER FINANCING SOURCES (USES)				
Kentucky Advance Revenue Program Proceeds	27,100	27,100	27,100	
KACO Lease-Mac Trucks		268,800	268,800	
Transfers From Other Funds		17,756		(17,756)
Transfers To Other Funds	(67,756)	(67,756)	(50,000)	17,756
Total Other Financing Sources (Uses)	(40,656)	245,900	245,900	
Net Changes in Fund Balance	(70,000)	(90,000)	(33,256)	56,744
Fund Balance - Beginning	70,000	90,000	96,379	6,379
Fund Balance - Ending	\$ 0	\$ 0	\$ 63,123	\$ 63,123

LEE COUNTY
BUDGETARY COMPARISON SCHEDULES - MAJOR FUNDS
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2006
(Continued)

	JAIL FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental Revenue	\$ 60,518	\$ 60,518	\$ 47,758	\$ (12,760)
Miscellaneous	100	100	40	(60)
Interest	50	50	142	92
Total Revenues	60,668	60,668	47,940	(12,728)
EXPENDITURES				
Protection to Persons and Property	240,125	240,125	228,988	11,137
Administration	9,300	9,300	5,565	3,735
Total Expenditures	249,425	249,425	234,553	14,872
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	(188,757)	(188,757)	(186,613)	2,144
OTHER FINANCING SOURCES (USES)				
Transfers From Other Funds	187,757	187,757	190,000	2,243
Total Other Financing Sources (Uses)	187,757	187,757	190,000	2,243
Net Changes in Fund Balance	(1,000)	(1,000)	3,387	4,387
Fund Balance - Beginning	1,000	1,000	9,758	8,758
Fund Balance - Ending	\$ 0	\$ 0	\$ 13,145	\$ 13,145

LEE COUNTY
BUDGETARY COMPARISON SCHEDULES - MAJOR FUNDS
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2006
(Continued)

LOCAL GOVERNMENT ECONOMIC ASSISTANCE FUND				
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental Revenue	\$ 215,000	\$ 347,766	\$ 362,942	\$ 15,176
Interest	50	50	320	270
Total Revenues	215,050	347,816	363,262	15,446
EXPENDITURES				
General Health and Sanitation	29,000	39,000	41,012	(2,012)
Roads	27,293	110,293	83,502	26,791
Total Expenditures	56,293	149,293	124,514	24,779
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	158,757	198,523	238,748	40,225
OTHER FINANCING SOURCES (USES)				
Transfers To Other Funds	(187,757)	(237,757)	(240,000)	(2,243)
Total Other Financing Sources (Uses)	(187,757)	(237,757)	(240,000)	(2,243)
Net Changes in Fund Balances	(29,000)	(39,234)	(1,252)	37,982
Fund Balances - Beginning	29,000	39,234	39,235	1
Fund Balances - Ending	\$ 0	\$ 0	\$ 37,983	\$ 37,983

LEE COUNTY
BUDGETARY COMPARISON SCHEDULES - MAJOR FUNDS
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2006
(Continued)

	AMBULANCE FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental Revenue	\$ 11,000	\$ 11,000	\$ 10,017	\$ (983)
Charges For Services	684,000	714,000	791,856	77,856
Miscellaneous	19,000	19,000	19,415	415
Interest Earned	100	100	245	145
Total Revenues	<u>714,100</u>	<u>744,100</u>	<u>821,533</u>	<u>77,433</u>
EXPENDITURES				
Protection to Persons and Property	688,478	742,478	726,755	15,723
Administration	202,800	202,800	189,828	12,972
Total Expenditures	<u>891,278</u>	<u>945,278</u>	<u>916,583</u>	<u>28,695</u>
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	<u>(177,178)</u>	<u>(201,178)</u>	<u>(95,050)</u>	<u>106,128</u>
OTHER FINANCING SOURCES (USES)				
Transfers From Other Funds	177,178	201,178	100,000	(101,178)
Total Other Financing Sources (Uses)	<u>177,178</u>	<u>201,178</u>	<u>100,000</u>	<u>(101,178)</u>
Net Changes in Fund Balances			4,950	4,950
Fund Balances - Beginning			<u>9,885</u>	<u>9,885</u>
Fund Balances - Ending	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 14,835</u>	<u>\$ 14,835</u>

LEE COUNTY
BUDGETARY COMPARISON SCHEDULES - MAJOR FUNDS
Required Supplemental Information - Modified Cash Basis
For The Year Ended June 30, 2006
(Continued)

SOLID WASTE FUND				
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental Revenue	\$ 0	\$ 19,277	\$ 19,277	\$ 0
Charges for Services	325,000	355,000	360,399	5,399
Miscellaneous			4,797	4,797
Interest	100	100	194	94
Total Revenues	325,100	374,377	384,667	10,290
EXPENDITURES				
General Health and Sanitation	269,289	285,016	300,927	(15,911)
Debt Service Principal	22,000	22,900	20,831	2,069
Debt Service Interest	7,200	9,850	9,038	812
Administration	72,064	102,064	70,792	31,272
Total Expenditures	370,553	419,830	401,588	18,242
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	(45,453)	(45,453)	(16,921)	28,532
OTHER FINANCING SOURCES (USES)				
Transfers From Other Funds	28,106	28,106		(28,106)
Total Other Financing Sources (Uses)	28,106	28,106		(28,106)
Net Changes in Fund Balances	(17,347)	(17,347)	(16,921)	426
Fund Balances - Beginning	17,447	17,447	51,816	34,369
Fund Balances - Ending	\$ 100	\$ 100	\$ 34,895	\$ 34,795

LEE COUNTY
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2006

Note 1. Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

The supplementary schedules - budget to actual comparisons include Kentucky Advance Revenue Program Proceeds of \$171,500 for the General Fund and \$27,100 for the Road Fund.

Note 2. Reconciliation of Budgetary Basis to Modified Cash Basis

Reconciliation of General Fund

Expenditures - Budgetary Basis	\$ 2,580,941
Less: Kentucky Advance Revenue Program	<u>(171,500)</u>
Expenditures - Modified Cash Basis	<u><u>\$ 2,409,441</u></u>
Other Financing Sources (Uses)	
Budgetary Basis	\$ 191,500
Less: Kentucky Advance Revenue Program	<u>(171,500)</u>
Modified Cash Basis	<u><u>\$ 20,000</u></u>

Reconciliation of Road Fund

Expenditures - Budgetary Basis	\$ 1,478,286
Less: Kentucky Advance Revenue Program	<u>(27,100)</u>
Expenditures - Modified Cash Basis	<u><u>\$ 1,451,186</u></u>
Other Financing Sources (Uses)	
Budgetary Basis	\$ 245,900
Less: Kentucky Advance Revenue Program	<u>(27,100)</u>
Modified Cash Basis	<u><u>\$ 218,800</u></u>

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LEE COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Year Ended June 30, 2006

**LEE COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

Fiscal Year Ended June 30, 2006

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses unqualified opinions on the governmental activities and each major fund of Lee County, Kentucky.
2. No reportable conditions relating to the internal control of the audit of the financial statements are reported in the Independent Auditor's Report.
3. No instance of noncompliance material to the financial statements of Lee County was disclosed during the audit.
4. No reportable conditions relating to the audit of the major federal awards programs are reported in the Independent Auditor's Report.
5. The auditor's report on compliance for the audit of the major federal awards programs for Lee County expresses an unqualified opinion.
6. There are no audit findings relative to the major federal awards programs for Lee County reported in Part C of this schedule.
7. The program tested as a major program was: Community Development Block Grant (CFDA 14.228)
8. The threshold for distinguishing Type A and B programs was \$300,000.
9. Lee County was not determined to be a low-risk auditee.

B. FINDINGS - FINANCIAL STATEMENT AUDIT

STATE LAWS AND REGULATIONS

None.

REPORTABLE CONDITIONS

None

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARDS PROGRAM AUDIT

None

D. PRIOR YEAR FINDINGS

Solid Waste Bills Totaling \$15,594 Were Waived Without Fiscal Court Approval

- *This finding has been corrected.*

Ambulance Bills Totaling \$60,870 Were Waived Without Fiscal Court Approval

- *This finding has been corrected.*

Late Fees For Solid Waste Collections Should Be Applied Consistently

- *This finding has been corrected.*

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LEE COUNTY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

LEE COUNTY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal Year Ended June 30, 2006

<u>Program Title</u>	<u>Grant Identification No.</u>	<u>Federal CFDA No.</u>	<u>Federal Expenditures</u>	<u>Total By CFDA #</u>
U.S. Department of Agriculture				
<i>Administered by U.S. Forest Service</i>				
National Forest - Dependent Rural Communities	04DG11083150490	10.670	6,225	\$ 6,225
U.S. Department of Commerce				
<i>Administered by NOAA</i>				
PRIDE	n/a	11.469	28,312	28,312
U.S Department of Housing and Urban Development				
<i>Passed through KY Governor's Office for Local Development:</i>				
Community Development Block Grant	B04DC210001/057	14.228	807,196	807,196 **
Appalachian Regional Commission				
<i>Passed through Governor's Office for Local Development</i>				
Flex-E Program for Economically Distressed Counties	M-05401709	23.001	20,000	20,000
U.S. Department of Health and Human Services				
<i>Passed through Ky State Board of Elections:</i>				
Voting Access for Individuals with Disabilities	n/a	93.617	65,000	65,000
U.S. Department of Homeland Security				
<i>Passed Through KY Office of Homeland Security</i>				
State Domestic Preparedness Support Program	M-04647883	97.004	1,696	
State Domestic Preparedness Support Program	M-04613409	97.004	1,902	3,598
Emergency Food and Shelter Program	345000-001	97.024	15,755	15,755
Emergency Management Performance Grant	M-05029993	97.042	3,924	3,924
Total U.S. Department of Homeland Security				<u>23,277</u>
TOTAL FEDERAL EXPENDITURES				<u><u>\$ 950,010</u></u>

*Tested as Major Program or Cluster ***

LEE COUNTY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2006

Note 1 - The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Lee County, Kentucky and is presented on a modified cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

ROSS & COMPANY, PLLC
Certified Public Accountants
800 Envoy Circle
Louisville, KY
Telephone (502) 499-9088
Facsimile (502) 499-9132
www.rosscpas.com

The Honorable Steve Mays, Lee County Judge/Executive
The Honorable L.C. Reese, Former Lee County Judge/Executive
Members of the Lee County Fiscal Court

Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards

We have audited the financial statements of the governmental activities and each major fund of Lee County, Kentucky, as of and for the year ended June 30, 2006, which collectively comprise the County's basic financial statements, as listed in the table of contents and have issued our report thereon dated September 27, 2006. Lee County prepares its financial statements in accordance with a basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Lee County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statement and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

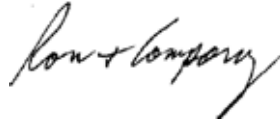
Compliance And Other Matters

As part of obtaining reasonable assurance about whether Lee County's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards
(Continued)

This report is intended solely for the information and use of management and the Governor's Office for Local Development and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ross & Company", written in a cursive, flowing style.

Ross & Company, PLLC

Audit fieldwork completed -
September 27, 2006

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

ROSS & COMPANY, PLLC
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Facsimile (502) 499-9132
www.rosscpas.com

The Honorable Steve Mays, Lee County Judge/Executive
The Honorable L.C. Reese, Former Lee County Judge/Executive
Members of the Lee County Fiscal Court

Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133

Compliance

We have audited the compliance of Lee County, Kentucky, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2006. Lee County's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Lee County's management. Our responsibility is to express an opinion on Lee County's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Lee County's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Lee County's compliance with those requirements.

In our opinion, Lee County complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006.

Internal Control Over Compliance

The management of Lee County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Lee County's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

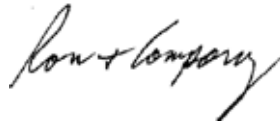
Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133
(Continued)

Internal Control Over Compliance (Continued)

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ross & Company", is written over a light blue horizontal line.

Ross & Company, PLLC

Audit fieldwork completed -
September 27, 2006

**CERTIFICATION OF COMPLIANCE -
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM**

LEE COUNTY FISCAL COURT

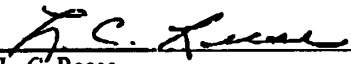
**For The Fiscal Year Ended
June 30, 2006**

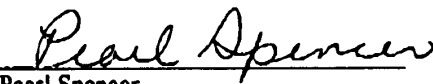
Appendix A

CERTIFICATION OF COMPLIANCE
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM
LEE COUNTY FISCAL COURT

For the Fiscal Year Ended June 30, 2006

The Lee County Fiscal Court hereby certifies that assistance received from the Local Government Economic Assistance Program was expended for the purpose intended as dictated by the applicable Kentucky Revised Statutes.


L. C. Reese
County Judge Executive


Pearl Spencer
County Treasurer